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MEMORANDUM

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FROM: Ernest G. Johnson *EGJ*
Director
Utilities Division

AZ CORP COMMISSION
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DATE: November 26, 2003

RE: STAFF REPORT FOR SANTA CRUZ WATER COMPANY AND PALO VERDE UTILITIES COMPANY- APPLICATIONS FOR EXTENSIONS OF ITS EXISTING CERTIFICATES OF CONVENIENCE AND NECESSITY FOR WATER AND WASTEWATER SERVICES (DOCKET NOS. W-03576A-03-0586 AND SW-03575A-03-0586)

Attached is the Staff Report for Santa Cruz Water Company and Palo Verde Utilities Company applications for Extension of their existing Certificates of Convenience and Necessity for water and wastewater services. Staff recommends approval with conditions.

EGJ:JEF:hml

Originator: Jim Fisher

Arizona Corporation Commission
DOCKETED

NOV 26 2003

DOCKETED BY	<i>[Signature]</i>
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Docket Nos. W-03576A-03-0586 and SW-03575A-03-0586

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**SANTA CRUZ WATER COMPANY
AND
PALO VERDE UTILITIES COMPANY**

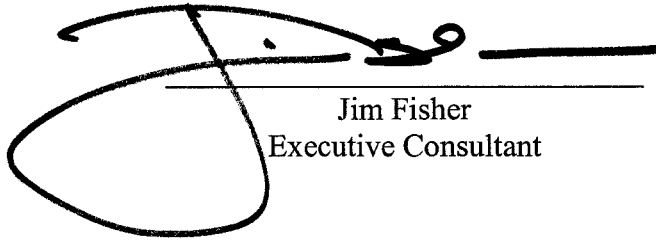
**DOCKET NOS. W-03576A-03-0586
AND
SW-03575A-03-0586**

**APPLICATIONS FOR EXTENSIONS
OF EXISTING CERTIFICATES
OF CONVENIENCE AND NECESSITY**

NOVEMBER 2003

STAFF ACKNOWLEDGMENT

The Staff Report for Santa Cruz Water Company and Palo Verde Utilities Company (Docket Nos. W-03576A-03-0586 and SW-3575A-03-0586) was the responsibility of the Staff members listed below. Jim Fisher was responsible for the review and analyses of the Company's application. Lyndon Hammon was responsible for the engineering and technical analysis.



Jim Fisher
Executive Consultant



Lyndon Hammon
Engineering Consultant

EXECUTIVE SUMMARY
SANTA CRUZ WATER COMPANY & PALO VERDE UTILITIES COMPANY
DOCKET NOS. W-03576A-03-0586 & SW-03575A-03-0586

On August 18, 2003, Santa Cruz Water Company, L.L.C. ("Santa Cruz") and Palo Verde Utilities Company ("Palo Verde") collectively referred to as ("The Utilities") filed with the Arizona Corporation Commission ("ACC" or "Commission") applications for extensions of existing Certificates of Convenience and Necessity ("CC&N") to provide water and wastewater services in portions of Pinal County, Arizona.

On October 6, 2003, the Commission issued Decision No. 66394, which authorized Santa Cruz and Palo Verde to extend its service territories and required compliance with numerous conditions. On October 29, 2003, and November 3, 2003, Palo Verde and Santa Cruz filed documentation to comply with portions of Decision No. 66394.

The requested territory is proposed to become 2,100 residential lots. Two of the parcels are located south of the CC&N extension area authorized on October 22, 2003. The third parcel is also south of the existing service territory and non-contiguous to either the existing service territory or the other requested areas.

The Arizona Department of Environmental Quality ("ADEQ") regulates Santa Cruz under ADEQ Public Water System I.D. # 11-131. Based on data submitted by the Company, ADEQ has determined that this system is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4. ADEQ reported that Palo Verde's wastewater treatment facility is in total compliance with its rules for operation, reporting, and discharge limits.

Staff recommends the Commission approve the Santa Cruz Water Company application subject to compliance with the following conditions:

1. To require Santa Cruz to charge its existing rates and charges in the proposed extension area.
2. To require Santa Cruz to file a copy of the developers' Certificate of Assured Water Supply related to the proposed extension area.
3. To require Santa Cruz to file a copy of the municipal franchise for the extension area.
4. To require Santa Cruz to complete compliance with all Staff recommendations listed within the "Recommendations" section of this Staff Report within 365 days of a decision in this matter or 30 days prior to serving its first customer within the proposed extension area, whichever comes first.
5. To require Santa Cruz to submit a report by June 30, 2004 describing its plan to reduce the arsenic level in its water.

Staff further recommends that the Commission's Decision granting this application be considered null and void without further order from the Commission should Santa Cruz fail to meet conditions 2 and 3 listed above within 365 days of any decision in this matter, and conditions 4 and 5 above within the time frame specified.

Staff recommends the Commission approve the Palo Verde application subject to compliance with the following conditions:

1. To require Palo Verde to charge its existing rates and charges in the proposed extension area.
2. To require Palo Verde to file a copy of the ADEQ approved CAAG 208 plan amendment, to the existing 1997 CAAG plan, with the Director of Utilities.
3. To require Palo Verde file copy of the municipal franchise for the extension area.
4. To require Palo Verde to complete compliance with all Staff recommendations within the "Recommendations" sections of this Staff Report within 365 days of a decision in this matter or 30 days prior to serving its first customer within the proposed extension area whichever comes first.

Staff further recommends that the Commission's Decision granting this application to Palo Verde, be considered null and void without further order from the Commission should Palo Verde, fail to meet conditions 2 and 3 listed above within 365 days of any decision in this matter, and condition 4 within the time specified.

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Introduction

On August 18, 2003, Santa Cruz Water Company, L.L.C. ("Santa Cruz" or "Water Company") and Palo Verde Utilities Company ("Palo Verde" or "Wastewater Company") collectively referred to as ("The Utilities") filed with the Arizona Corporation Commission ("ACC" or "Commission") applications for extensions of existing Certificates of Convenience and Necessity ("CC&N") to provide water and wastewater services in portions of Pinal County, Arizona.

On September 4, 2003, The Utilities were provided notice that the applications had been found sufficient.

On September 23, 2003, The Utilities filed a notice of deletion of certain properties from the August 18, 2003 applications.

With regard to a previous CC&N Extension application for other properties in Pinal County, on October 6, 2003, the Commission issued Decision No. 66394, which authorized The Utilities to extend their service territories and required compliance with numerous conditions. On October 29, 2003, and November 3, 2003, Palo Verde and Santa Cruz filed documentation to comply with portions of Decision No. 66394.

Background

Palo Verde and Santa Cruz are Arizona Limited Liability Corporations ("LLCs") engaged in providing wastewater and water utility services to approximately 885 water customers and 636 wastewater customers. The Commission granted both Palo Verde Utilities Company, an Arizona Corporation, and Santa Cruz Water Company, an Arizona Corporation ("The Corporations"), CC&Ns in Decision No. 61943 (September 17, 1999). The Corporations were initially incorporated by Mr. Michael Reinhold, a principle in Pecan Investments L.L.C. Mr. Reinhold is also a principle of RHS Properties, Inc., which, in conjunction with El Dorado Holdings, Inc., and Phoenix Capital Partners, L.L.C. is involved in the development of Rancho El Dorado located in an area directly northeast of the Town of Maricopa in Pinal County.

On October 6, 2003, the Commission issued Decision No. 66394, which approved the transfer of the CC&Ns from the corporations to the LLC's. The Decision additionally authorized Santa Cruz and Palo Verde to extend its service territories to include approximately 3,226 acres consistent with the associated conditions required by the Commission. These conditions included a requirement that Santa Cruz and Palo Verde provide within 30 days of the decision a list of the assets, approvals, liabilities and management arrangements transferred to the LLC. The Commission further required The Utilities to obtain performance bonds totaling \$500,000 each.

The Commission also required The Utilities to file monthly status reports and copies of all subsequent pleadings related to Mr. Reinbold's Oregon Circuit Court \$60 million judgment for financial fraud, as well as any pleadings or correspondence of the pledge agreement.

On October 29, 2003, The Utilities filed a notice of compliance with Decision No. 66394. The Utilities provided an amended legal description, amended county franchise, a curtailment tariff, the required performance bonds and a list of the members in the Pecan Valley Investment LLC and El Dorado Pecan LLC.

The October 29, 2003 compliance filing did not provide a list of the assets, approvals, liabilities and management arrangements transferred to the LLC as required by the Commission as a condition to the CC&N extension.

On November 3, 2003, The Utilities filed its monthly status report on Mr. Reinbold's Oregon Circuit Court judgment. The Utilities provided a copy of a October 1, 2003, letter from Lisa Kaner, Special Assistant Attorney General in Oregon, asserting concern that Mr. Reinbold may have violated the asset pledge agreement associated with his appeal of the Oregon judgement. The Attorney General's office requested Mr. Reinbold confirm under oath information previously provided by his legal representatives.

On November 17, 2003, Staff was informed by counsel for The Utilities that Mr. Reinbold had not responded to the Oregon Department of Justice letter of October 1, 2003.

The Extension Application

In this application, Palo Verde and Santa Cruz initially applied for six (6) distinct areas identified as 1.) Desert Cedars Equities L.L.C.; 2.) HAM Maricopa L.L.C.; 3.) Land Solutions Maricopa, L.L.C.; 4.) Elliot Homes, Inc.; 5.) Performance Construction Inc/NU-CO-BB1-L.L.C.; and 6.) Newport Holdings.

On August 28, 2003, Sonoran Utility Services, L.L.C. ("Sonoran") sought to intervene in The Utilities application. Sonoran informed the Commission that it had contracted to manage the organization and provide service for two Pinal County Improvement Districts. Sonoran informed the Commission that certain properties included in The Utilities extension application were signed to be included in the two Pinal County Improvement Districts, and are therefore "Contested Parcels."

On September 22, 2003, The Utilities filed notice with the Commission to delete certain properties from the pending application. The Utilities deleted areas identified as 1.) Desert Cedars Equities L.L.C.; 2.) HAM Maricopa L.L.C.; and 3.) Land Solutions Maricopa, L.L.C.

The requested remaining territory is to be developed into 2,100 residential lots. Two of the retained parcels are located south of the CC&N extension area authorized on October 6,

2003. The third parcel is also south of the existing service territory and non-contiguous to either the other requested areas or existing service territory.

Finance of Utility Facilities

The Utilities will finance the required utility facilities through a combination of shareholder equity and advances in aid of construction. Advances in aid of construction are often in the form of main extension agreements. Main extension agreements are a standard industry practice. Arizona Administrative Code R14-2-406 and R14-2-606 established the minimal acceptable criteria for line extension agreements between water and wastewater utilities and private parties. Main extension agreements generally require the developer to design, construct and install (or cause to be), all facilities to provide adequate service to the development. Upon acceptance of the facilities by the utility, the developer will convey the facilities by way of a warranty deed. The utility will refund a minimum of ten (10) percent of the annual revenue associated with development for a period of at least ten (10) years.

Santa Cruz has proposed main extension agreements with developers requesting service. The main extension agreements provide that the utility shall refund seven percent of the gross annual revenue received from the associated facilities beginning four (4) years after the facilities are accepted by the utility. The utility will pay the seven (7) percent annual refund to the developer for twenty-two (22) years. This refund provision exceeds the minimum refund standard in the current applicable rule.

Palo Verde has proposed wastewater main extension agreements with developers requesting service. The wastewater main extension agreements provide that the utility shall refund two and one-half (2.5) percent of the gross annual revenue received from the associated facilities beginning four (4) years after the facilities are accepted by the utility. The utility will pay the two and one-half (2.5) percent annual refund to the developer for twenty-two (22) years. The Commission's rules on wastewater main extension agreements does not currently require a refund of the advance. Therefore, Palo Verde's refund provision exceeds the minimum refund standard in the current applicable rule.

Water Infrastructure

Santa Cruz has five (5) existing well sources, which will provide water. One well is on line and serves the present customer base. Two of the five wells have been refitted and equipped, and are being held for future use. The Company also has 1.5 million gallons of existing water storage.

Production of the existing wells is as follows:

DWR # 55-612737	950 gal/min
DWR # 55-617336	2,000 gal/min
DWR # 55-621410	1,000 gal/min

DWR # 55-621407	1,960 gal/min
DWR # 55-621408	2,150 gal/min

As part of this application, the Water Company submitted a water master plan which outlined planned growth rates through 2009, mapped the location of existing and future major water transmission mains, and described phasing of additional water storage and water production. Based on the present and planned facilities, the Company has adequate storage and production to serve its present customer base and can readily develop adequate storage and production to serve its anticipated customer base.

However, as a matter of analysis, the potential water problem for the water company is not quantity, but quality. The service area is characterized by groundwater which is high in nitrates, fluorides, arsenic, and total dissolved solids (salinity). These parameters are all removable, but the treatment is complex and expensive, and could impact rates.

The well in service meets all the inorganic maximum contaminant levels, but has an arsenic concentration between 11 and 13 $\mu\text{g/l}$. (The well meets the present arsenic standard of 50 $\mu\text{g/l}$ but will not meet the January 2006 arsenic standard of 10 $\mu\text{g/l}$.)

Based on this arsenic level, the Company will be required to implement a plan to meet the new arsenic standard. This could mean installing treatment facilities, locating a better source of water or blending sources of water to achieve 10 $\mu\text{g/l}$ or less. Therefore, Staff recommends that the Company submit a report to the Commission's Utilities Division by June 30, 2004, describing what steps the Company is planning to take in order to reduce the level in its water to a concentration below 10 $\mu\text{g/l}$.

Curtailment Plan Tariff

A curtailment tariff is an effective tool to allow a water company to manage its resources during periods of shortages due to pump breakdowns, droughts, or other unforeseeable events. On October 29, 2003, Santa Cruz filed a curtailment tariff for compliance with Decision No. 66394.

Arizona Department of Environmental Quality Capacity Development

Arizona Department of Environmental Quality ("ADEQ") regulates the Santa Cruz Water Company under ADEQ Public Water System I.D. # 11-131. Based on data submitted by the Company, ADEQ has determined that this system is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

ADEQ reported that the Palo Verde Utilities wastewater treatment facility is in total compliance with its rules for operation, reporting, and discharge limits.

ADEQ Capacity Development rules, effective September 23, 1999, require new public drinking water systems to meet distinct financial, managerial and technical capacity requirements. ADEQ will accept a financial determination made by the Commission as meeting the financial capacity requirements for new water systems under the jurisdiction of the Commission. The technical and managerial capability is determined by ADEQ. All three components are combined in the final approval of the water company's "elementary business plan", pursuant to ADEQ R18-4-606. The three components are reviewed and approved sequentially, with the technical capacity approval and "Approval To Construct" being the last performed. The Approval to Construct acts as a control point in the process, and once an Approval to Construct has been issued, it can be assumed that the water company has complied with the capacity development rules.

Santa Cruz and Palo Verde have provided Staff with copies of current ADEQ "Approvals to Construct."

Arizona Department of Water Resources Compliance

Santa Cruz is within the Pinal Active Management Area ("AMA"), and consequently is subject to reporting and conservation rules (GPCD requirements). The Pinal AMA reported that Santa Cruz Water Company is in total compliance with the Arizona Department of Water Resources reporting and conservation rules.

Wastewater Infrastructure

The existing wastewater treatment plant is an aerated lagoon with a capacity of 300,000 gallons per day. Wastewater flows for the year ending 2002 were 111,000 gallons per peak day for 636 customers. Palo Verde has begun construction on a new mechanical wastewater treatment plant, which will be built in three equal phases with an initial Phase I capacity of 1 million gallons per day ("MGD") ADEQ has given notice of its intent to issue an aquifer protection permit for the total plant capacity of 3.0 MGD. (Based on an experienced flow of 180 gallons per day-service, 3.0 MGD should serve about 16,000 homes.) Effluent disposal will be accomplished by agricultural reuse, golf course irrigation, recharge, and discharge to surface water via a federal National Pollution Discharge Element System permit.

Wastewater collection and treatment cannot be approached in a fragmented manner. Instead, it demands area wide planning and co-ordination between publicly owned treatment works, cities, sanitary districts, and privately owned wastewater treatment plants. Pursuant to that goal, Section 208 of the Federal Water Pollution Control Act (Public Law 92-500) provided for the preparation of "Certified Areawide Water Quality Management Plans" and the designation of entities to manage sewage treatment facilities and sewage collection systems in the respective planning area.

The Central Arizona Association of Governments ("CAAG") is the designated water quality planning agency for the requested CC&N areas in this application. CAAG has the

authority to develop and approve general wastewater plans which include land development policies, service areas, objectives, principles and standards for local growth and development.

The Commission has generally awarded CC&N areas, contingent upon conformance with general or specific §208 plans. In this case, Staff relied chiefly upon CAAG and the specific §208 plans for recommendations in this application. Critical weight was given to the planning documents, because the applicant has requested wastewater service territories, in advance of much actual construction and service.

Palo Verde holds an existing CAAG §208 plan for this wastewater utility and it was approved by the ADEQ in October 1997. The proposed extension area is outside the original CAAG §208 planning area. Staff recommends that the Company be required to amend the CAAG §208 plan to include the proposed CC&N extension area before providing service to any permanent customers consistent with Decision No. 66394.

The new wastewater treatment plant will have treatment and disposal capacity to serve about 16,000 homes (at 3.0 MGD and 180 gallons / peak day-service) and presently holds the necessary environmental permits for a 3.0 MGD facility. Palo Verde's master plan and proposed CAAG §208 amendment will provide for expansion in additional phases to 9.0 MGD and finally 14.0 MGD. The additional phases will occur as the market and growth conditions dictate. Therefore, it appears that Palo Verde has the wastewater treatment and disposal capacity or can develop the capacity to serve both the existing and proposed CC&N area.

Authorized Rates

Palo Verde and Santa Cruz will provide service in the proposed extension area under its currently authorized rates and tariffs.

ACC Compliance

A check with the Utilities Division Compliance Unit showed that Santa Cruz and Palo Verde are in compliance.

Recommendations

Water Service CC&N Extension

Staff recommends the Commission approve the Santa Cruz Water Company, an Arizona Limited Liability Company, application for an extension of the Certificate of Convenience and Necessity in portions of Pinal County to provide water service, subject to compliance with the following conditions:

1. To require the Santa Cruz Water Company, an Arizona Limited Liability Company, to charge its existing rates and charges in the proposed extension area.

2. To require Santa Cruz Water Company, an Arizona Limited Liability Company, to file a copy of the developers' Certificate of Assured Water Supply related to the proposed extension area.
3. To require Santa Cruz Water Company, an Arizona Limited Liability Company, to file a copy of the municipal franchise for the extension area.
4. To require Santa Cruz to complete compliance with all Staff recommendations listed within the "Recommendations" section of this Staff Report within 365 days of a decision in this matter or 30 days prior to serving its first customer within the proposed extension area, whichever comes first.
5. To require Santa Cruz to submit a report by June 30, 2004 describing its plan to reduce the arsenic level in its water.

Staff further recommends that the Commission's Decision granting this application be considered null and void without further order from the Commission should Santa Cruz fail to meet conditions 2 and 3 listed above within 365 days of any decision in this matter, and conditions 4 and 5 above within the time frame specified.

Waste Water CC&N Extension

Staff recommends the Commission approve the Palo Verde Utilities Company, an Arizona Limited Liability Company, application for an extension of its Certificate of Convenience and Necessity in portions of Pinal county to provide wastewater service, subject to compliance with the following conditions:

1. To require the Palo Verde Utilities Company, an Arizona Limited Liability Company, to charge its existing rates and charges in the proposed extension area.
2. To require Palo Verde Utilities Company, an Arizona Limited Liability Company, to file a copy of the ADEQ approved CAAG 208 plan amendment, to the existing 1997 CAAG plan, to the Director of Utilities.
3. To require Palo Verde Utilities Company, an Arizona Limited Liability Company, to file a copy of the municipal franchise for the extension area.
4. To require Palo Verde to complete compliance with all Staff recommendations within the "Recommendations" sections of this Staff Report within 365 days of a decision in this matter or 30 days prior to serving its first customer within the proposed extension area whichever comes first.

Santa Cruz Water Company L.L.C and
Palo Verde Utilities Company
Docket Nos. W-03576A-03-0586 and SW-03575A-03-0586
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Staff further recommends that the Commission's Decision granting this application to Palo Verde, be considered null and void without further order from the Commission should Palo Verde, fail to meet conditions 2 and 3 listed above within 365 days of any decision in this matter, and condition 4 within the time specified.